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Supreme Court, U.S.
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No. 03-918

IN THE

Supreme Court of the United States

CHEVY CHASE BANK, F.S.B., ET AL.,
Petitioners,

v.

DALE WELLS, ET AL.
Respondents.

On Petition for a Writ of Certiorari to the Maryland Court of Appeals

REPLY TO BRIEF IN OPPOSITION

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CORPORATE DISCLOSURE STATEMENT

Petitioners reiterate the following corporate disclosures pursuant to Supreme Court Rule 29.6:

1. Chevy Chase Bank, F.S.B. states that 80% of its stock is owned by the B.F. Saul Real Estate Investment Trust. No other publicly-held corporation owns 10% or more of its stock.

2. Bank One Delaware, N.A. states that it is a wholly-owned subsidiary of Bank One Corporation.

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INTRODUCTION

Respondents, attempting to justify the decision of the court below and to explain away the clear conflict between that decision and the uniform precedents of this Court and lower federal courts, simply echo the lower court's erroneous reasoning and misunderstanding of the applicable precedents. As we briefly reiterate in Part III below, the decision of the Maryland Court of Appeals violates the well-established rule that a contractual choice-of-law provision that designates the governing *state* law cannot, under the Supremacy Clause, be interpreted as choosing that particular state law over preemptive federal law.

Apparently recognizing that both the holding and rationale of the Maryland Court of Appeals' opinion inherently conflict with this principle, Respondents seek to avoid review on two grounds not related to that conflict. First, they contend that this Court has no jurisdiction because the decision below is not a "final judgment" under 28 U.S.C § 1257. (Brief in Opposition ("Opp.") 8-12.) Second, Respondents assert that the *particular language* of the specific choice-of-law provision in issue here somehow renders it unworthy of review and distinguishes this case from the uniform line of cases holding that such provisions cannot, as a matter of law, be interpreted to subject the defendant to liability for failure to comply with preempted state law. (Opp. at 6-7, 17, 19-21, 26.) Both of these arguments are wrong, as we explain in Parts I and II below.

ARGUMENT

I. THIS COURT HAS JURISDICTION

Although acknowledging that the opinion below is a final decision on the federal question whether preempted state laws can be revived through "interpretation" of choice-of-law provisions, Respondents argue that the judgment below is not "final" under 28 U.S.C. § 1257(a) because the decision did

not entirely dispose of the case. (Opp. 8-12.) As Respondents concede, however, this Court has never interpreted the finality requirement of § 1257 "to preclude review 'where anything further remains to be determined by a State court, no matter how dissociated from the only federal issue that has finally been adjudicated by the highest court of the State.'" *Cox Broad. Corp. v. Cohn*, 420 U.S. 469, 477 (1975) (quoting *Radio Station WOW, Inc. v. Johnson*, 326 U.S. 120, 124 (1945)). Rather, "the Court has recurringly encountered" and granted review in "situations in which the highest court of the State has finally determined the federal issue presented in a particular case, but in which there are further proceedings in the lower state courts to come." *Cox*, 420 U.S. at 477.

The present case comes squarely within the fourth category of exceptions to the finality rule identified in *Cox*:

> [W]here the federal issue has been finally decided in the state courts with further proceedings pending in which the party seeking review here might prevail on the merits on nonfederal grounds, thus rendering unnecessary review of the federal issue by this Court, and where reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action . . . , [and] if a refusal immediately to review the state-court decision might seriously erode federal policy, the Court has entertained and decided the federal issue . . . .

Id. at 482-83. *See Goodyear Atomic Corp. v. Miller*, 486 U.S. 174, 178-80 (1988) (applying exception to review interlocutory state court decision rejecting federal preemption defense); *Southland Corp. v. Keating*, 465 U.S. 1, 6-8 (1984) (same).

Here, the Maryland Court of Appeals has finally decided the federal preemption question, anterior to the state law

issues, and a reversal of that decision would end the case. Conversely, eschewing review of the final federal question, at a minimum, "*might* seriously erode federal policy." *Cox*, 420 U.S. at 483 (emphasis added). For the reasons stated in the Petition, it is clear that permitting state courts to subject federal lenders to otherwise preempted state laws under the guise of contract interpretation would seriously erode, if not destroy, the express policy of the federal Office of Thrift Supervision ("OTS") to occupy the field through comprehensive and *uniform* national regulations so that federal lenders would not be "subject to a hodgepodge of conflicting and overlapping state lending requirements." *Lending & Investment*, 61 Fed. Reg. 50951, 50965 (Sept. 30, 1996). *See also* 12 C.F.R. § 560.2.

For this reason, the fourth *Cox* exception to finality has routinely been applied to preemption issues, because it is the fact of subjecting parties to inconsistent and preempted state law that undermines the federal regulatory scheme. In *Goodyear Atomic Corp.*, for example, the Court applied its "pragmatic approach" to the finality rule to a decision in which the Ohio Supreme Court held that the Supremacy Clause did not bar the application of state workers' compensation laws to a private contractor operating a federally owned nuclear production facility. 486 U.S. at 176, 179. Although the state court had remanded the matter for further administrative proceedings to determine the employee's application for a supplemental compensation award, this Court held that it had jurisdiction to review the preemption question, which had been finally determined by the state court. *Id.* at 179. The Court noted that reversal "would preclude any further proceedings" and that "even if appellant prevails before the [state administrative agency] on nonfederal grounds . . . the unreviewed decision of the Ohio Supreme Court might seriously erode federal policy in the area of nuclear production." *Id.* Accordingly, the Court

determined that it had jurisdiction to review the decision under section 1257. *Id.* at 180, 186.

Similarly, in *Southland*, this Court granted review of a California Supreme Court decision holding that the state's Franchise Investment Law, which precluded arbitration of claims brought under that statute, was not preempted by the Federal Arbitration Act ("FAA"). 465 U.S. at 4-5. This Court pointed out that "to delay the review of a state judicial decision denying enforcement of the contract to arbitrate until the state-court litigation has run its course" would keep in effect a state court decision holding that the state statute did not conflict with the FAA, while reversal of that decision would terminate litigation on the merits. *Id.* at 6-7.

As these cases conclusively demonstrate, Respondents are simply wrong in suggesting that federal policy is eroded only where there is a direct conflict between state and federal law or where the First Amendment is implicated. (Opp. at 11-12.) To the contrary, the state court's interference with a field preemption regulation is the paradigmatic example of a situation where immediate review is needed, because subjecting covered institutions to further state court proceedings challenging actions authorized by preemptive federal law creates the very "obstacle to the accomplishment and execution of the full purposes and objectives" of the preemptive federal law. *Fid. Fed. Savs. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 156 (1982). *See also* 12 C.F.R. § 560.2(a)-(b).

Indeed, Respondents' jurisdictional argument simply assumes the validity of their merits argument that the decision below does not undermine the federal scheme or conflict with this Court's precedent (because that precedent, in Respondents' erroneous view, only reaches *direct* conflict preemption). *Cox* itself cautioned against such putting of the cart before the horse by noting that, for determining whether a decision is sufficiently "final" for jurisdictional purposes, the question is "only" whether there is a "substantial" issue

concerning disruption of the federal scheme and whether the "federal issue" on the merits was "arguably wrongly" decided. 420 U.S. at 486, n.13. The present appeal more than meets those threshold tests.[1]

II. THE LANGUAGE OF THE CHOICE-OF-LAW PROVISION IS IRRELEVANT TO THE QUESTION PRESENTED HERE

Respondents make much of the fact that the choice-of-law provision here refers to "Subtitle 9 of Title 12 of the Commercial Law Article of the Maryland Annotated Code" ("Subtitle 9") instead of "Maryland law."[2] But the particular *form* of the choice-of-law provision – which, in this case, was dictated by the peculiarities of Maryland's dual usury laws (Pet. 3 n. 1) – has no effect on the basic legal question for which review is sought here: whether such contractual choice-of-law provisions may ever be invoked as grounds for

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[1] The sole case cited by Respondents (Opp. at 11) in support of their contention that the fourth *Cox* exception does not apply, *Florida v. Thomas*, 532 U.S. 774 (2001), is inapposite. The state court decision in that criminal case did not finally dispose of the federal constitutional question regarding the search and seizure in issue, and a narrow opinion on one strand of Fourth Amendment law would not affect issues "common to all run-of-the-mine decisions suppressing evidence in criminal trials." *Id.* at 778-80. Here, the federal issue has been finally decided in the state court, and the decision below *is* common to all cases involving "run-of-the-mine" choice-of-law provisions.

[2] The choice-of-law provision also expressly designates "applicable federal laws," a phrase that Respondents studiously ignore. To the extent such minutia is relevant, that language more directly refutes an "election" of preempted state law than did *Fid. Fed. Savs. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982), or the subsequent lower federal court decisions, all of which involved choice-of-law provisions that referred only to state law. *See* Pet. 8, 12-14. Thus, the *Fidelity* court and subsequent courts had to *read* preemptive federal law into the contracts under the basic Supremacy Clause principle that state law necessarily incorporates superior federal law. *Fidelity*, 458 U.S. at 157.

imposing preempted state law obligations on activities expressly authorized by dominant federal law.

That issue is squarely presented here because the Maryland Court of Appeals attached *no* significance to the specific language of this choice-of-law provision – as evidenced by the fact that Respondents' *post hoc* "savings" construction of that court's decision is unsupported by a single citation to the opinion. Rather, as the Petition establishes, the court below broadly held that the mere reference in a choice-of-law provision to preempted "'state laws or policies external to the agreement'" may constitute a contractual promise to engage in the activity required by the preempted state law, which is to be decided purely as a "contract interpretation issue . . . , a question of state law." (Pet. App. 39a (quoting *Am. Airlines v. Wolens*, 513 U.S. 219, 233 (1995).) The opinion nowhere suggests that the precise wording of the choice-of-law provision affects this general principle or that a different rule might obtain because the contract references a particular provision of state law that is concededly preempted, rather than all state law, *including* the concededly preempted state law being invoked by plaintiffs. Moreover, the Maryland Court of Appeals found that its decision was consistent with OTS's field preemption regulations because the regulation purportedly exempts all state contract claims, without regard to the particular language of the contractual provisions. (Pet. App. 22a-23a.) Indeed, Respondents themselves, after suggesting that the particular language of this contract is somehow dispositive and distinguishes other cases, advance precisely the broad and erroneous legal principle articulated by the court below, *i.e.*, under *Wolens*, any choice-of-law reference to external state law is equivalent to a contractual commitment to abide by all such state laws (save, perhaps, laws requiring a *violation* of federal law) and the OTS regulation does not preempt any such contractual actions.

Thus, the dispute between Petitioners and both the lower court and Respondents turns on the legal question whether a

choice-of-law provision's mere reference to a preempted regulatory scheme *may* be interpreted as a binding contractual commitment or whether *Fidelity* and the lower court decisions following it preclude state courts from an "interpretation" that replaces a uniform federal scheme with subordinate state law. Respondents offer no reason why this legal question is affected in any way by whether the choice-of-law provision refers to all state law or only to that law relevant to the transaction and which provides the basis for alleging a breach.

Moreover, as the Petition established, one of the principal evils of interpreting choice-of-law provisions to incorporate preempted state laws is that it confronts institutions with a Hobson's choice between either eschewing such beneficial provisions or being deemed to have resurrected state laws inconsistent with federal law. Here, Chevy Chase faced precisely such a Hobson's choice because it was required to specify Subtitle 9 to ensure that the "new" and more flexible state usury laws would apply to the Cardholder Agreement to the extent expressly contemplated by controlling *federal* laws.[3] A standard generic reference to Maryland law would automatically have constituted an election of the "old" rather than "new" usury laws. MD. CODE ANN., COM. LAW § 12-913.1.

Again, however, it is irrelevant *how* a court interprets particular choice-of-law language because *any* reference to external state law cannot, under the Supremacy Clause,

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[3] The "most favored lender" provisions set forth in the OTS field preemption regulations permit federal thrifts like Chevy Chase to charge interest "at the maximum rate permitted to any state-chartered . . . lending institution by the law of that state." 12 U.S.C. § 1463(g); 12 C.F.R. § 560.110(b). Thus, the inclusion of Subtitle 9 in the Governing Law clause effectively designated the 24 percent interest rate limit in § 12-903(a)(1) of Subtitle 9 as the applicable interest rate limit under the Cardholder Agreement, rather than the lower and less flexible interest rates permitted under the "old" Maryland usury law.

somehow provide a basis for a contractual cause of action under that inferior, preempted state law. *See* Pet. 7-11.[4]

III. RESPONDENTS MISCONSTRUE THE APPLICABLE LAW

The Petition explains how the decision below misconstrues and conflicts with the decisions of this Court in *Fidelity* and *Wolens* as well as with the lower federal courts that have applied those cases. (Pet. 7-19.) Respondents have no answer. They share the Maryland Court of Appeals' basic misunderstanding of *Fidelity*, arguing that it involved a direct conflict between state and federal law. *See* Opp. 17-18 and Pet. App. 35a-36a. Petitioners have already explained why this purported distinction is both factually wrong and legally irrelevant. (Pet. 14-16.) Respondents also repeat the lower court's erroneous view of *Wolens*. *See* Opp. 13-17 and Pet. App. 38a-40a. And, like the court below, Respondents misread the "savings clause" of the OTS field preemption regulations, which protects basic state contract and commercial laws, as permitting the imposition of preempted state regulatory provisions by means of a contractual choice-of-law provision. *See* Opp. 22-25 and Pet. App. 22a-24a. OTS itself has rejected that position. (Pet. App. 106a-107a.) Thus, Respondents' assertion that they have a "contract claim" conflicts with the uniform line of federal authorities holding that a choice-of-law provision cannot be read as an express contractual agreement to comply with an otherwise preempted state regulatory law. *See* Pet. 20-21.

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[4] Contrary to Respondents' suggestion, it does not matter whether state courts interpret choice-of-law provisions faithfully or with an eye toward furthering the state's understandable interest in preserving its laws against preemption. The harm to uniform federal regulation occurs when federal lenders are subject to the "hodgepodge of conflicting and overlapping state lending requirements" depending upon their alleged intent reflected in the choice-of-law provision, as interpreted by state courts under state law canons of contract construction.

Respondents also mischaracterize this Court's decision in *Volt Info. Sciences, Inc. v. Bd. of Trustees*, 489 U.S. 468 (1989), as supporting their contention that a choice-of-law provision "can obligate a party to comply with otherwise preempted state laws." (Opp. 16-17.) On the contrary, *Volt* held that the FAA did *not* preempt state procedural laws governing arbitration proceedings. 489 U.S. at 475. For that reason alone, the Court did not review the California Supreme Court's interpretation of the choice-of-law provision in that case. *Id.* at 474.

Subsequently, however, this Court did reach the contract interpretation question and held that in view of the federal policy in favor of arbitration, a state choice-of-law provision in an arbitration agreement could not be interpreted to apply state rather than federal procedural law to arbitration proceedings pursuant to the contract. *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 60-62 (1995). *See also Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 294-95 (3d Cir.), *cert. denied*, 534 U.S. 1020 (2001).[5]

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[5] Respondents mischaracterize *Roadway Package*. (Opp. 19-20.) There, the Third Circuit decided, consistent with *Mastrobuono*, that a choice-of-law provision designating Pennsylvania law cannot be read to choose that law rather than federal law for purposes of arbitration proceedings. *Roadway Package*, 257 F. 3d at 289, 294-98. Rather, such an intent could reasonably be inferred only if there were a separate contract provision that specifically expressed that intent, such as a provision stating that the parties intended to arbitrate all claims in accordance with the Pennsylvania Arbitration Act. *Id.* Under that reasoning, the choice-of-law provision here could not be read to obligate Chevy Chase to follow the preempted notice provisions of Subtitle 9, but could be inferred only if the change-in-terms provision of the Cardholder Agreement explicitly stated, "Chevy Chase will give notice of any amendments in accordance with the notice provisions of Subtitle 9." The change-in-terms provision in fact states that Chevy Chase will give notice of amendments in accordance with "applicable law," which, pursuant to OTS regulations, is federal law. *See* 12 C.F.R. § 560.2(b)(9) (preempting state laws purporting to impose notice and disclosure requirements on federally-chartered lenders).

The present case is more compelling, for it involves an express federal preemption and intent to occupy the entire field of lending regulation of federal savings institutions. If a *non-preemptive* federal policy precludes interpretation of a contractual choice-of-law provision to select state instead of federal law, as *Mastrobuono* holds, it necessarily follows that a choice-of-law provision cannot be interpreted to subordinate *preemptive* federal law to preempted state law.

In sum, Respondents provide no reason for this Court to deny review of the decision below. Indeed, their Opposition reaffirms the fundamental incompatibility of the decision below with the clear teaching of *Fidelity* and its progeny, and underscores why this Court's immediate review is needed to prevent further damage to the uniform, national regulatory scheme that OTS has established.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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